



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

# DRAFT

Date:	02/21/14	Bill No:	<a href="#">Assembly Bill 2429</a>
Tax Program:	Sales and Use Special Taxes and Fees	Author:	Patterson
Sponsor:	Author	Code Sections:	RTC 6591.5
Position:	Support	Effective Date:	01/01/15

## BILL SUMMARY

This bill makes the interest rate paid on overpayments the same as the rate paid on late payments with respect to Board of Equalization (BOE)-administered tax and fee programs.

## ANALYSIS

### CURRENT LAW

Existing law<sup>1</sup> requires persons who are late paying a tax, fee, or surcharge (collectively “tax”) to pay a 10% penalty, plus interest on the unpaid tax from the tax due date to the last day of the month of payment. The BOE calculates interest on a late payment based on the Internal Revenue Service (IRS) rate,<sup>2</sup> plus 3%. That rate is 6% currently.

Existing law also requires the BOE to pay interest on tax overpayments unless the overpayment was intentional or due to carelessness. The law requires a different interest calculation on overpayments than for late payments. For overpayments, the law specifies that interest is computed based on the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent.<sup>3</sup>

Since July 1, 2009, the bond equivalent rate of 13-week treasury bills has been so low that, when rounded to the nearest full percent, the rate is zero. Consequently, since July 1, 2009, the BOE has not paid interest on tax overpayments.

Before July 1, 1991, the same interest rates applied on overpayments and late payments. However, AB 2181<sup>4</sup> and SB 179<sup>5</sup> changed the tax overpayment interest rate. Instead of the IRS rate plus 3%, the law requires interest paid on overpayments to be the bond equivalent rate of 13-week treasury bills auctioned – a rate generally 6- 8% lower. Therefore, current law sets the interest rate on overpayments significantly lower than the rate charged on late payments.

## REVISED REVENUE ESTIMATE

<sup>1</sup> Division 2 of the Revenue and Taxation Code.

<sup>2</sup> Internal Revenue Code Section 6621.

<sup>3</sup> If that rate is a multiple of ½ of 1 %, the rate increases to the next highest full percent.

<sup>4</sup> Chapter 85, Stats. 1991.

<sup>5</sup> Chapter 88, Stats. 1991.

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### PROPOSED LAW

This bill deletes the provisions that specify the tax overpayment interest rate shall be equal to the bond equivalent rate of 13-week treasury bills auctioned. The bill specifies that the modified adjusted rate per annum (for late payments and overpayments) means the rate determined in accordance with IRS's underpayment rate plus 3%.

The bill also defines "modified adjusted rate per month, or fraction thereof" to mean the modified adjusted rate per annum divided by 12.

The various BOE-administered special tax and fee laws currently reference these provisions for the applicable interest rates. Accordingly, these proposed changes apply also to those programs' overpayment interest rates.

### BACKGROUND

The chart on page 4 of this analysis provides an overview of the interest rates since 1987. Due to an unfavorable decision in *Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300, the Department of Finance (DOF) proposed a revised method for computing overpayment interest. The court decision involved sales and use tax issues related to U. S. Government contractors in California and resulted in BOE tax refunds associated with specified U.S. Government transactions. DOF suggested this change due to the potentially significant revenue loss resulting from interest on those tax refunds.

Since 1992, 16 different bills have been introduced to provide equal interest rates on overpayments and late payments (see chart on page 5 of this analysis). The BOE voted unanimously to sponsor 13 of those 16 measures, the most recent in 2013 (AB 1049, Harkey, et al.). However, due to the fiscal effect, either the policy or fiscal committee held all but one. The Legislature approved a 1992 measure one year after the interest rate disparity was enacted, but Governor Pete Wilson vetoed the legislation. In his veto message, Governor Wilson stated:

"Legislation enacted last year (Chapter 85, Statutes of 1991) established a separate, lower rate for state and local sales tax refund liability. Chapter 85 was enacted to minimize the impact of accruing interest as a result of the Aerospace decision. This bill would reverse that legislation, thereby reinstating the higher rate on refund liability.

"Imposing a lower rate for refunds minimizes the impact on the state in the event of large taxpayer refund liability. Imposing a higher rate on amounts owed by taxpayers serves as an incentive for taxpayers to remit those amounts in a timely manner as well as to comply with the law. I do not wish to change these incentives."

### COMMENTS

- 1. Sponsor and purpose.** As sponsor of the bill, the author notes that in 1991, the Legislature reduced the rate paid on overpayments dramatically because of an unfavorable court decision which required the state to refund significant amounts with interest. These court-ordered refunds have long since been paid, and it is time to end the significant disparity that has existed for over two decades.
- 2. Interest is not a penalty.** The law imposes penalties for late payments of tax, fees and surcharges. Interest, however, represents a charge for the use of funds. In the

same manner the state charges interest when a taxpayer makes a late payment, the state too should pay interest when taxpayers overpay.

3. **This bill better aligns BOE's overpayment interest rate with the IRS and Franchise Tax Board (FTB).** The IRS and the FTB do not have disparate interest rates on non-corporate overpayments and underpayments. The IRS has only a 1% disparity for corporate overpayments (the disparity is higher if the corporate underpayment is over \$100,000 or the corporate overpayment exceeds \$10,000). For corporate overpayments, the FTB has a 4% disparity.
4. **The law prohibits interest on intentional overpayments.** In the tax, fee, and surcharge programs the BOE administers, current law specifies that if the BOE determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest. This serves as a disincentive for intentional overpayments made to gain interest.

## COST ESTIMATE

The administrative costs are absorbable.

## REVENUE ESTIMATE

### BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

During calendar year 2013, the BOE made refunds of \$252 million in sales and use tax; and an estimated \$50 million under the BOE's special tax and fee programs. Since July 1, 2009, the credit interest rate (paid on overpayments) has been 0%. Since July 1, 2012, debit interest rate (charged on underpaid taxes) has been 6%. If credit interest and debit interest been equal over approximately 4 calendar years, the BOE would have paid out approximately \$21.9 million in credit interest.

### REVENUE SUMMARY

Since an interest rate change affects interest accrued only after the bill's effective date, the full effect of the increased overpayment interest rate will take a number of years to be fully realized. A 6% overpayment rate increase will have a total first year effect for all BOE tax and fee programs of \$2.6 million. The full effect of \$21.9 million will occur in the fourth year.

Year	State		Total	Local	District	Total
	Special Taxes	Sales & Use Tax				
2014-15	350,000	1,162,077	1,512,077	801,997	240,926	2,555,000
2015-16	1,300,000	4,316,286	5,616,286	2,978,845	894,869	9,490,000
2016-17	2,950,000	9,794,648	12,744,648	6,759,687	2,030,665	21,535,000
2017-18	3,000,000	9,960,659	12,960,659	6,874,258	2,065,083	21,900,000

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

Analysis prepared by:	Sheila T. Waters	(916) 445-6579	04/04/14
Revenue estimate by:	Bill Benson	(916) 445-0840	
Contact:	Michele Pielsticker	(916) 322-2376	
Is		2429ab022114revisedrevstws.docx	

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**Board of Equalization**  
**Interest Rates 01/01/87 through Current**

From	To	Assessments	Refunds
01/01/87	09/30/87	11%	11%
10/01/87	12/31/87	13	13
01/01/88	03/31/88	14	14
04/01/88	09/30/88	13	13
10/01/88	03/31/89	14	14
04/01/89	09/30/89	15	15
10/01/89	06/30/91	14	14
07/01/91	12/31/91	14	6
01/01/92	06/30/92	13	6
07/01/92	12/31/92	12	4
01/01/93	06/30/93	11	3
07/01/93	12/31/94	10	3
01/01/95	06/30/95	11	4
07/01/95	06/30/96	12	6
07/01/96	12/31/98	12	5
01/01/99	06/30/99	11	5
07/01/99	12/31/99	10	4
01/01/00	12/31/00	11	5
01/01/01	12/31/01	12	6
01/01/02	06/30/02	10	4
07/01/02	06/30/03	9	2
07/01/03	06/30/04	8	1
07/01/04	06/30/05	7	1
07/01/05	12/31/05	8	2
01/01/06	06/30/06	9	3
07/01/06	12/31/06	10	4
01/01/07	06/30/08	11	5
07/01/08	12/31/08	10	3
01/01/09	06/30/09	8	2
07/01/09	12/31/09	8	0
01/01/10	06/30/11	7	0
07/01/11	12/31/11	6	0
01/01/12	06/30/12	7	0
07/01/12	06/30/14	6	0

The following table provides the legislative history of the various measures that previously have addressed the interest rate disparity. The BOE sponsored the bills in **bold**.

Year	Legislation	Proposal	Final Status
2013	<b>AB 1049</b> Harkey, et al.	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2012	<b>AB 2048</b> , Donnelly	Equalize interest rates	Held in Assembly Appropriations Committee
2011	<b>SB 421</b> , Correa	Equalize interest rates	Senate Governance and Finance Committee adopted amendments to reduce the interest rate on underpayments by 3%; bill was subsequently held in Senate Appropriations Committee
2008	<b>AB 1926</b> , Shirley Horton	Equalize interest rates	Held in Assembly Revenue and Taxation Committee
2005	AB 1589, Villines	Equalize interest rates	Held in Assembly Appropriations Committee
2001	<b>SB 825</b> , Poochigian	Equalize interest rates	Held in Senate Revenue and Taxation Committee
2000	Stats. 2000, Ch. 607 ( <b>AB 2612</b> )	As introduced, equalize rates	Enacted to add an uncodified section that declares the intent of the Legislature that the interest rates be the same
2000	<b>AB 1208</b> , AR&T Comm.	Equalize interest rates	Provisions amended out in Senate Appropriations Committee
1999	<b>AB 464</b> , Maldonado	Equalize interest rates	Held in Assembly Appropriations Committee
1997	<b>AB 222</b> , Takasugi	Equalize interest rates	Amended in the Senate to increase the credit interest rate by 1%, but held in the Senate Appropriations Committee
1995	AB 397, Hannigan	Equalize interest rates	Comprehensive measure to make many significant changes to the tax laws and vetoed by Governor Wilson (interest rate provision not specifically addressed in veto message)
1995	AB 1190, Morrissey	Equalize interest rates	Provisions amended out in Assembly Revenue and Taxation Committee
1995	<b>AB 1189</b> , Takasugi	Equalize interest rates	Held in the Senate Appropriations Committee
1994	<b>AB 3487</b> , Andal	Equalize interest rates	Held in the Assembly Revenue and Taxation Committee
1993	<b>AB 2083</b> , Takasugi	Equalize interest rates	Never heard in committee
1992	<b>AB 2972</b> , Mays	Equalize interest rates	Vetoed by Governor Wilson